MARCH/APRIL 1985 THREE DOLLARS

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CORPORATE TAKEOVERS

WHY IS NO ONE SAFE?

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Forbes

March 11, 1985
Volume 135
Number 5

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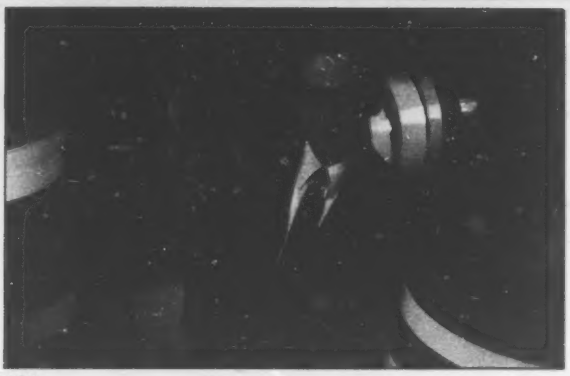

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March 11, 1985 Volume 135 Number 5 Forbes (ISSN 0015 6914) is published biweekly, except weekly during two weeks in April and two weeks in October, by Forbes Inc., 60 Fifth Ave., New York, N.Y. 10011. Second-class postage paid at New York, N.Y. and at additional mailing offices. Subscription $42 a year, U.S.A. Postmaster: Send address changes to Forbes, 60 Fifth Ave., New York, N.Y. 10011.

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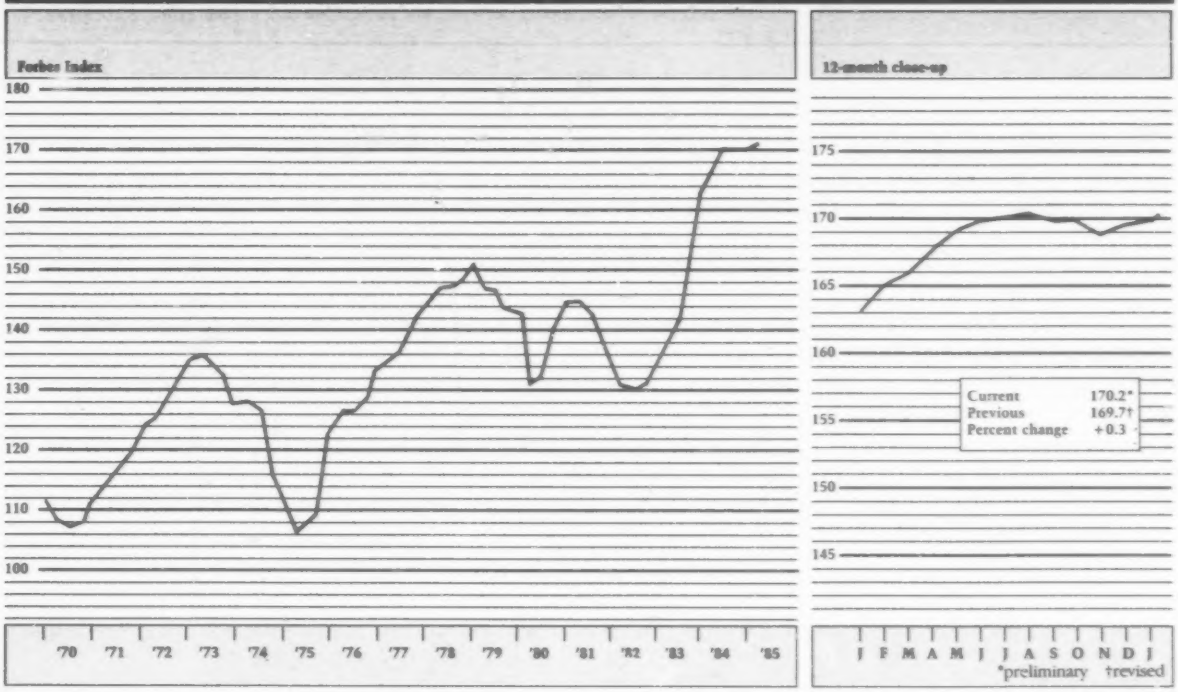
Cover illustration: Phil Huling, after Edvard Munch

The Forbes Index



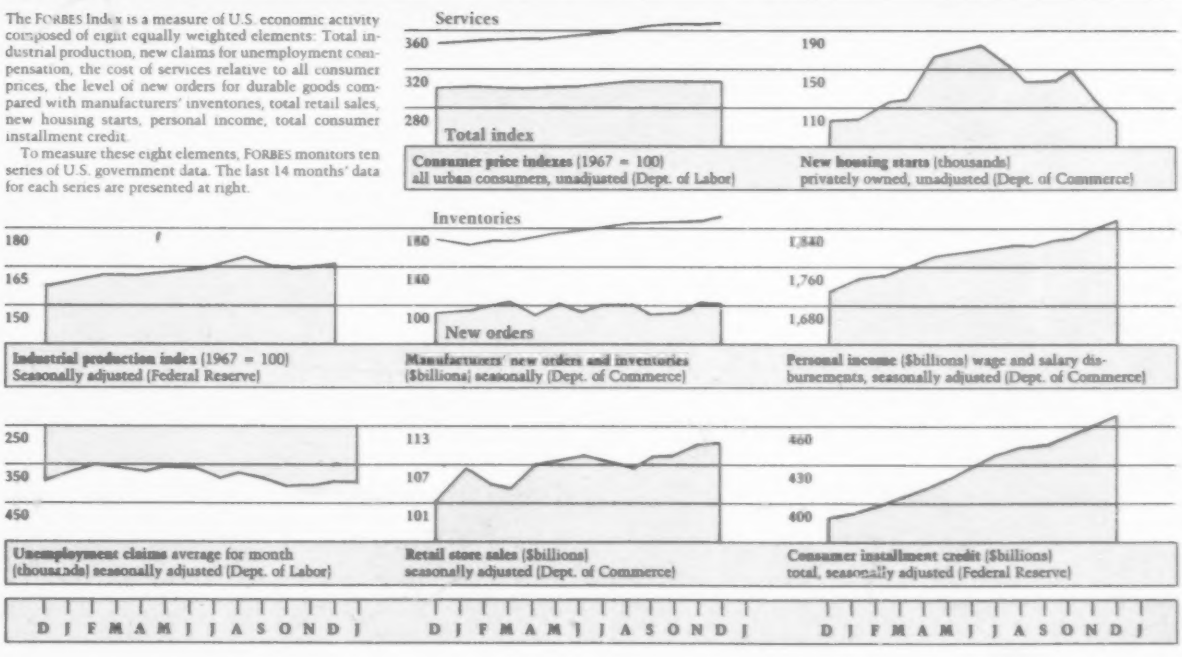
New high ground. The Forbes Index nudged to a record level in the latest reporting period when it registered a 0.3% gain. Consumer installment credit shows a 1.5% rise over the previous month. The latest figure also stands some 20.6% higher than it was one year ago. Personal income is up only 7.9% over the same time period. While there is always a danger that consumers will become overextended, this risk is tempered by the comparatively mild growth shown in the consumer price index.

New unemployment claims are worth watching. They rose only 0.1% over the previous month but stand 7.1% higher than they were the same time last year.

The Forbes Index Components

The FORBES Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 14 months' data for each series are presented at right.



nership agreement that functioned like a men's club," says Kaiser. "When a partner retired, his units were redistributed to the remaining partners in proportion to the units they already held. So there was no incentive." Kaiser changed all that. Under the new arrangement, shares in the company—and thus income—are distributed on a merit basis; the better your individual office did the previous year, the greater your share in the firm and its profits.

Kaiser has also been forced to offer specialized services just like the Big Eight to protect his client base. That means a new Washington tax office and the new centralized administrative offices in Houston.

Of course, all of this costs money. PKF partners now make an average of $100,000 apiece. L&H partners make about 40% more. The difference is going back into the firm, and Kaiser keeps reassuring partners that it's just a capital investment; they will see it coming back some day.

As long as Kaiser keeps struggling to modernize and strengthen PKF, he'll continue to run the firm. Unless, of course, PKF is acquired. "We are approached annually by Laventhol & Horwath to merge with them," says Kaiser. While Kaiser can't rule out the possibility, he denies PKF is really interested. "Look at it this way," he says. "If everybody bigger than us merged, that would be great: We'd be number two."—**Richard Greene**

The Up & Comers

Dealmakers

Why blue-blooded investment banks are wooing small technology firms.

What's in a name?

Question: What do Lam Research, General Electric and Ford Motor have in common? Answer: They all use the same investment banker—Goldman, Sachs & Co. Lam is small ($19.1 million sales), but it's not stupid. When the Fremont, Calif. manufacturer of plasma etch semiconductor equipment had the chance to let Goldman, Sachs lead-underwrite its tiny $19.5 million issue last May, it jumped. Hambrecht & Quist, the first choice of a lot of Up & Comers, was relegated to the number two spot.

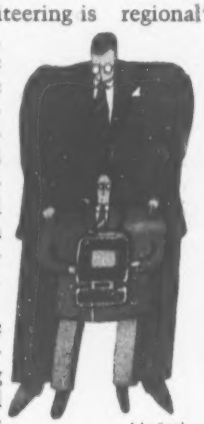
The heavy hitters in IPOs

Domestic initial public offerings for 13 months by ten big New York investment banks and the "Four Horsemen" of new issues.

Lead underwriter	Capital raised* (millions)	Number of issues	Weighted avg price change since offering†
Merrill Lynch	$566	18	16%
Shearson Lehman	293	8	28
First Boston	229	5	28
Goldman, Sachs	155	7	19
Drexel Burnham	152	13	16
Morgan Stanley	144	5	55
Paine Webber	109	10	42
Dean Witter	109	8	–6
Kidder, Peabody	79	8	–1
Bear, Stearns	79	7	7
Alex. Brown	127	5	45
LF Rothschild	81	6	21
Hambrecht & Quist	26	3	27
Robertson, Colman	24	2	55

*Initial public offerings, Jan.1, 1984 to Jan. 31, 1985.
†Prices on 2/8/85.
Source: Securities Data Co.; CompuServe.

It isn't every day that Goldman, Sachs spends time courting the likes of Lam Research. Big investment underwriters normally enter the cyclical new-issues market only when it's red-hot. Such fair-weather profiteering is often born of inexperience, the kind that burned some of the big boys during the last bull market for new issues, in 1983. Fortune Systems, underwritten in 1983 by First Boston, was recently down 88% from its initial price. Even staid Morgan Stanley flubbed on Activision, which was down 90% from the offering.


John Segal

"If one out of every three deals is hurting the reputation of your firm, how long can you stay in?" says Bill Comfort, head of Citicorp's venture capital subsidiary.

But the market faded last year, and the big Wall Street firms are still hustling up new-issues business. "Amazingly, they haven't lost heart," says Sandy Robertson of Robertson, Colman & Stephens, a regional underwriter in San Francisco. Why?

The big investment banks haven't lost heart because they can't afford to, with the prospect of shrinking profit growth in traditional corporate finance. Now their determination may be paying off. Last year they raised far more capital than the small regional investment banks—known as the Four Horsemen—that used to dominate new issues: Hambrecht & Quist and Robertson, Colman & Stephens in San Francisco; L.F. Rothschild, Unterberg, Towbin in New York; and Alex. Brown & Sons in Baltimore.

Morgan Stanley's 1984 new domestic underwritings are up a whopping 55%, and Paine Webber's are up 42% *(see table)*. Alex. Brown's $127 million in initial public offerings (IPOs) are up 45%, but generally the regionals underwrote only a handful of new issues. The market rally has dramatically helped their stocks: L.F. Rothschild's new issues, down an embarrassing 18% in late January, are now up 21%.

The Four Horsemen haven't entirely lost their touch, of course. But lately they're often being paired with bigger underwriters, as in the Lam Research deal. "More and more, you're seeing companies going public that want both a big Wall Street firm and a regional" underwriting their stock, says Edward Mathias, president of the T. Rowe Price New Horizons Fund.

The weapon the big firms are using to clean up in new issues is hardly more than their name. That may not sound like much, but reputation counts for a lot in this ephemeral market. Big names can induce institutional investors to cough up capital, even in a down market. "There was nobody we didn't bring out because of the market," boasts Carter McClelland, Morgan Stanley managing director.

Prestige was on the mind of Tom Bruggere, president of Mentor Graphics, when he picked Morgan to handle his IPO. "The fact that our underwriter did British Telecom carried across very well [with customers]," he says; this was particularly so in Japan, "which is very prestige-oriented."

Besides a big name, can the big-name firms offer the entrepreneur

anything the regionals can't? Not new ways of financing, says Tom Volpe, Hambrecht's chief operating officer. "Our companies are almost invariably equity financers," he says. "They don't need those Byzantine financings that emanate from Wall Street."

The same goes for research, where the regionals have a distinct edge from following high-technology companies for years. Alex. Brown, for example, which specializes in software research, "has done a better job of understanding our industry than anybody else," says Larry Wilson, president of Policy Management Systems, a Columbia, S.C. producer of software for property and casualty insurers.

But give the big houses an edge in trading muscle. Take a fragile company like Lam public and rumors are inevitable. Twice Goldman, Sachs played hero and defused potentially damaging rumors about the company's financial health by dispatching salesmen to put nervous institutional shareholders at ease. Goldman also bought stock sold through other marketmakers, recalls Tom Nicoletti, a grateful Lam founder. The stock recovered both times from as low as 6⅝ to the current 11⅞, just above its offering price of 10.

Why are firms like Goldman making markets in thinly traded stocks? Mostly to hedge against competition in the big corporate finance markets. Morgan Stanley, for example, got a lot friendlier to small firms when the SEC introduced Rule 415—the "shelf rule." By allowing entire bond issues to be bought up at short notice, it shrank profit margins for investment bankers. Compared with giants like Salomon Brothers, Morgan was at a competitive disadvantage because it didn't have as much capital to risk. So, to drum up new business, it began its high-technology effort.

Others, sensing a sea change in the economy, have also plunged in. "Our traditional clients in the smokestack industries are net capital generators now, not net users," says First Boston Managing Director George Weiksner. "In the last five years over 40% of new equity capital went to technology companies, even though technology companies are only 20% of the market value of all equities."

But Up & Comers should be careful when the big boys call. "The excitement on their side, and the flattery they bestow, can be gone tomorrow," says Robert Swanson, whose Linear Technology Corp. is being wooed by investment banks for its first underwriting. "If you hiccup, they'll all disappear."—**Robert McGough**

The Up & Comers

Ploys

Phonograph cartridge maker Joe Grado loves opera more than money. So he's not . . .

Facing the music

Manhattan-born Joseph Grado has rarely been one to hang back when opportunity knocked. At 16 he dropped out of vocational high school, where he had been studying to be a watchmaker, and went to work for Tiffany & Co. (no less) as a watchmaker. When he discovered stereo sound in the early Fifties, he went to Long Island City-based audio pioneer Saul Marantz to help him improve the sound of his system. Impressed by Grado's ear, Marantz sent him over to Sherman Fairchild's floundering hi-fi stereo division. With that kind of introduction Grado promptly landed a job. The minute he came up with a viable product idea, Grado went out on his own, scraping together $2,000 to produce cartridges he designed. A cartridge picks up vibrations from the needle and converts them into electric impulses that are then transmitted to the rest of the stereo. In 1955 he opened a factory in Brooklyn on the site of his Sicilian-born father's grocery store.

Since then Grado has built his privately owned Grado Laboratories from $75,000 in sales its first year to roughly $4 million last year. Joe Grado may not be Akio Morita of Sony, but his little company has never had an unprofitable year, and it allows him to indulge his own musical tastes, which run to singing Verdi and making violins. These days he puts in only a few hours a month at his Brooklyn plant.

But now, at 60, Grado has a problem, like the rest of the audio business. Since 1980 total sales of separate audio component hardware, such as turntables and receivers, have stagnated. That has driven some specialty companies, like headphone manufacturer Koss, into Chapter 11. Sales of cartridges have fallen from an estimated $88.5 million in 1979 to $77.2 million last year. Since Grado ranks well behind market leaders Shure and Audio-Technica, he is clearly under pressure.

Meanwhile, technology threatens. Prerecorded audiocassettes already outsell records by 3-to-2. Other threats to Grado's cartridges are just now becoming affordable. Players of compact disks (CDs), digitally encoded aluminum disks read by a laser beam, now sell for under $300, compared with over $1,000 in 1983. That has helped unit sales jump from 35,000 in 1983 to 200,000 last year. They could double again in 1985. CDs, which are also falling in price (they average $13 to $16), give exceptional sound quality and aren't subject to either the surface noise or wear and tear of phonograph records.

But Grado remains skeptical about the quality of compact disk sound. "A lot of this so-called advantage of CDs is PR hype," he argues. "The same guys who are touting it publicly are not that enthusiastic privately."

Ted Kappler

Joe Grado rehearsing at home
All this, and Carnegie Hall, too.

The new devices have another hidden problem, he goes on. CDs, like videodisks, will be slower to catch on because they cannot record, says Grado. "In my estimation, it's just a stopgap until the real stuff comes out." And what might that be? He thinks the new 8mm videocassette could become an audio medium in which the audio part of a miniaturized videocassette recorder will both record and play music as well as video. He estimates the potential market for such a product "in the millions, not the hundreds of thousands."

So what's Grado's strategy? First, he's counting on being able to outlive his big competitors in the shrinking

As the American economic environment changed, predators emerged from under rocks and began to prey on healthy businesses. Is there no stopping them? Will they devour us all?

Why is no one safe?

By Allan Sloan

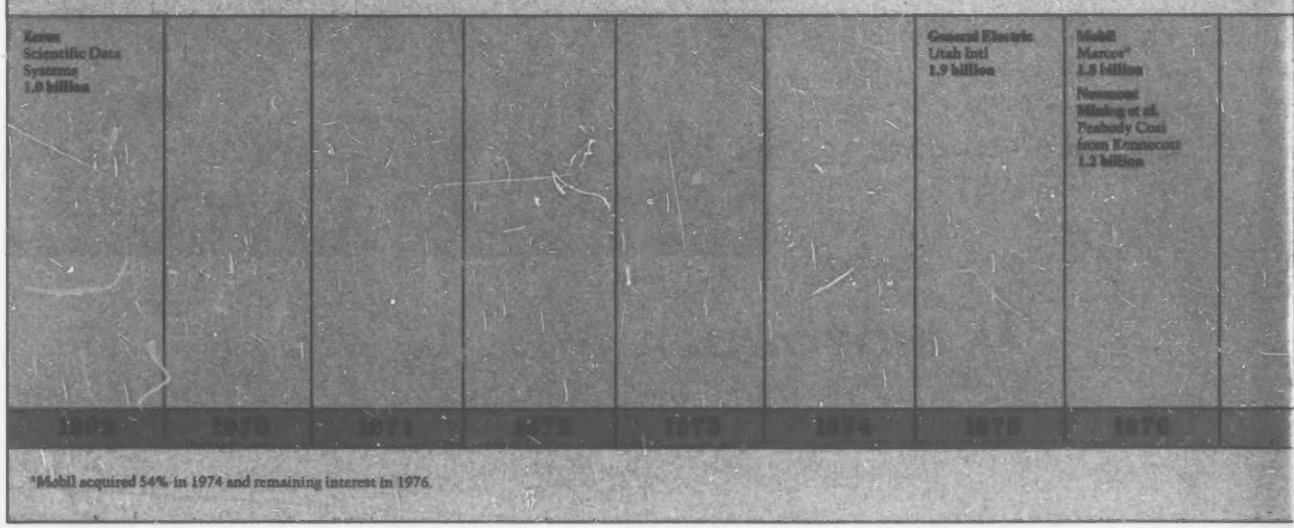
WHAT KIND OF WORLD are we living in? Texaco, the seventh-largest company in the U.S., is so unnerved by the Bass brothers' buying a 9.9% stake that it hands them a $400 million greenmail profit to go away. Mobil Corp., the fourth-largest company, is so worried that it will be the next company held for ransom that it's asking shareholders to put antigreenmail provisions in its corporate charter.

Not long ago, no one could even conceive of buying Texaco or Mobil, let alone seriously entertain such a thought. Who could raise the money for such a deal? These days, lots of people can. Carl Icahn can send Drexel Burnham Lambert out to raise $4 billion as part of an $8 billion proposal to take over Phillips Petroleum, the nation's 22nd-largest company. T. Boone Pickens and his pipsqueak Mesa Petroleum Co. could so discombobulate Gulf Corp., the nation's 14th-largest company, that it put itself up for sale and was bought for $13 billion by Chevron Corp. The leveraged buyout firm of Kohlberg Kravis Roberts & Co., which came close to buying Gulf, assembled $6 billion of bank loan commitments for a deal that would have had a debt-equity ratio of 30-to-1. Wherever you look, the sharp-toothed little minnows are chasing the whales and sometimes swallowing them.

Who is safe? Only those companies in such wretched shape that no one wants them and those with such a high stock price that no one can afford to pay a premium over the market. Who is vulnerable? All those companies

Billion-dollar babies

It wasn't long ago that buying something for a billion dollars made you distinctive. Xerox, using its overpriced stock, first pierced the barrier with its disastrous purchase of Scientific Data Systems. Ten-digit deals weren't common until the 1980's, with Reaganomics and the 1981 tax law in full swing and antitrust enforcement in full retreat.



*Mobil acquired 54% in 1974 and remaining interest in 1976.

whose underlying assets are worth more than the price of their stock—which means most big companies these days.

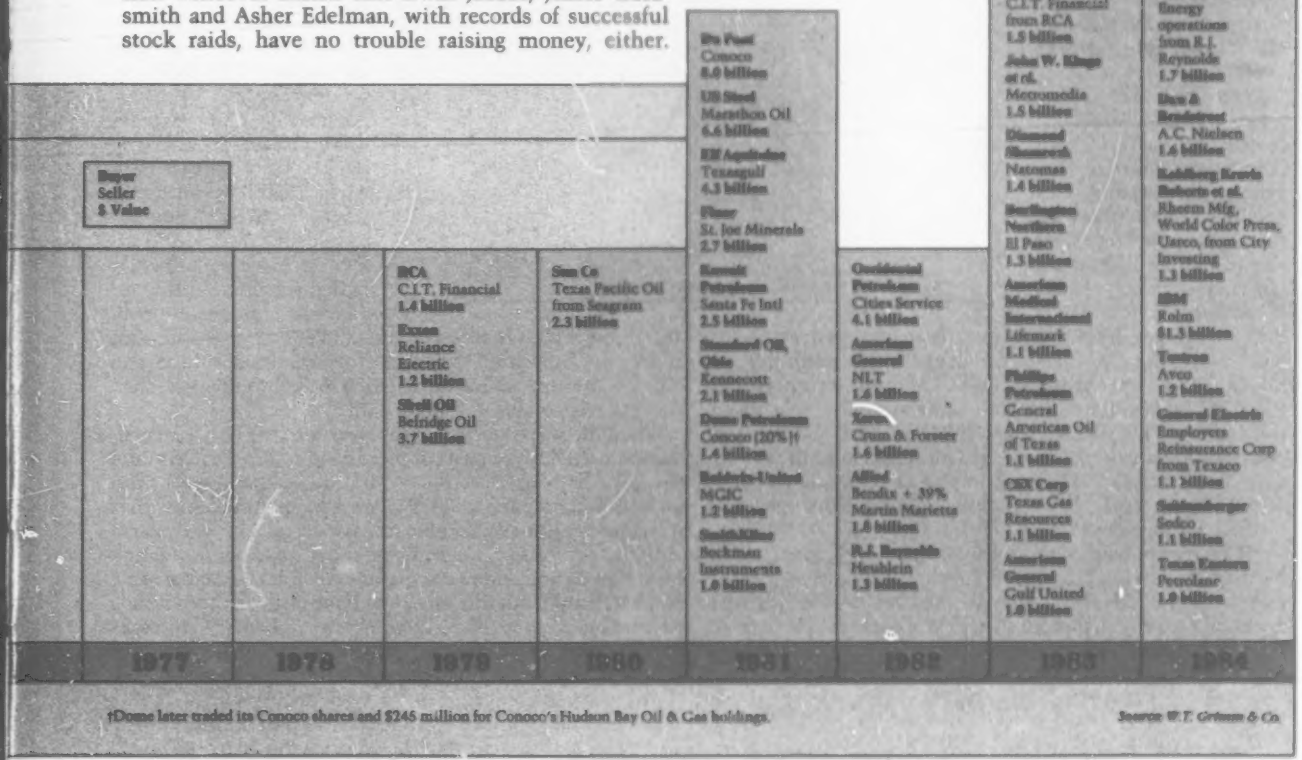
But why are so many big corporations being raided now? Companies' assets have been worth more than their stocks for years—at least since the great stock market crash of 1974, after which stock prices as a whole failed to keep up with the great inflation in property values. Why now, when the stock market has finally come to life and sailed past the old highs set in the 1970s? With the Dow Jones index around 1300, stock price-to-asset ratios are higher now than they have been for several years *(see chart, p. 136)*. So why are gargantuan takeover deals happening now, rather than in 1974 or a few years ago, when price-to-asset ratios were at their low point?

Credit a series of seemingly unconnected factors: bank deregulation, unanticipated fallout from the 1981 tax law, and a new breed of investment bankers and lawyers who handle multibillion-dollar transactions as easily as their predecessors handled $100 million transactions.

Add to these new factors the virtual elimination of antitrust restrictions based on size under the Reagan Administration. Combine all this with the long-standing underlying undervaluation of stocks and you have the making of a whole new situation. Businesses become mere commodities for trading in the marketplace as casually as a sack of sugar or a suburban house. If your business is a troubled one, don't break your back dealing with the problems, just trade it in for a different model.

As a final ingredient, throw in a major, unprecedented destabilizing factor: well-financed takeover entrepreneurs such as Icahn, who recently raised $400 million by having his ACF Industries float a bond issue through Drexel Burnham. Oscar Wyatt's Coastal Corp. raised $600 million through Drexel last year. Other Drexel beneficiaries: Boone Pickens, the Belzberg family and Ivan Boesky, who together raised more than three-quarters of a billion dollars. Takeover sharks like Irwin Jacobs, James Goldsmith and Asher Edelman, with records of successful stock raids, have no trouble raising money, either. These people don't need to raise all the money necessary to pay for a whole company. They just need enough for a credible stake, so they can extract greenmail money or put the target in play for another company to buy. Boone Pickens has become so adroit that he can play two big oil companies at once. First he went after Phillips. After negotiating a separate peace, under which his investor group got the right to sell its shares back to Phillips for $53 a share plus $25 million in "expenses," equal to another $2.80, Pickens moved on Unocal. He said he had bought 7.9% of the company for $584 million and planned to spend up to $616 million more. Where would Pickens and his investor group get $1.2 billion? From the loan commitments they originally obtained to buy Phillips stock.

Without cooperation from the banks, all this would not have evolved. Banks practically throw money at takeover deals because acquisition loans carry high rates and fat fees at a time when bank profits are under pressure. Banks have lost most of their cheap deposits because of deregulation and are loaded with expensive money market accounts and other high-cost funds. Profit margins on most loans to big corporate borrowers are paper-thin because these companies can threaten to bypass the banks with commercial paper. But takeover financ-



†Dome later traded its Conoco shares and $245 million for Conoco's Hudson Bay Oil & Gas holdings.

Source: W.T. Grimm & Co.

ing and leveraged buyout loans are lucrative.

Inadvertently, the 1981 Economic Recovery Tax Act helped fatten the corporate victims for the knife. The act was designed to spur economic expansion by allowing companies to take ultrarapid depreciation. One result was that cash flow grew faster than reported earnings. Unimaginative analysts and naive investors failed to see that this was strengthening the quality of corporate earnings; the sharp-eyed takeover artists quickly grasped the meaning. Because the extra cash wasn't reflected in earnings, ERTA didn't give stock prices an upward push. But by increasing cash flow, ERTA made corporate assets better collateral for takeover loans.

This last insight comes from SEC Chairman John S.R. Shad, formerly a top-notch corporate finance man at E.F. Hutton. "There's a differential between what people can justify paying for 100, 1,000 or 10,000 shares of stock and the value of taking over the entire company," he says.

The tax act so increased corporate cash flows that many companies now sell at "low multiples of their real cash flow and their ability to service debt," Shad adds. "They have substantial untapped borrowing capacity, which allows acquirers to finance a substantial part of the acquisition price against the acquisition itself." Hence also the recent phenomenon of leveraged buyouts—which are simply another form of takeover.

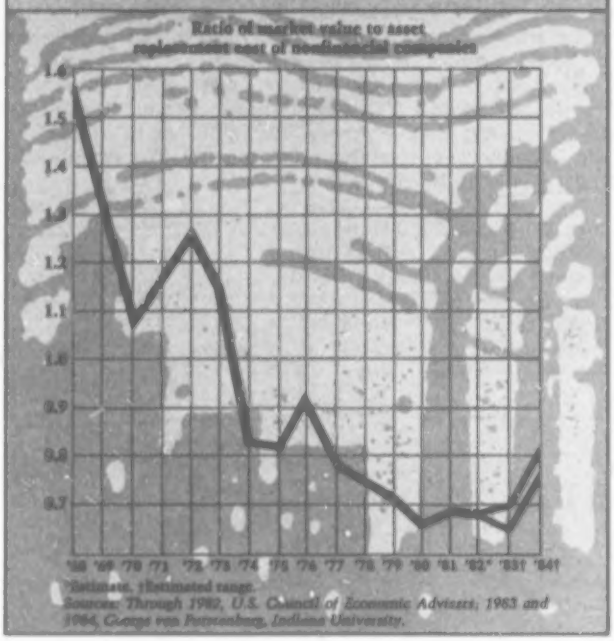
Even the extra cash flow wouldn't have allowed takeovers of giant companies four or five years ago, because few people on Wall Street had the experience and expertise to handle billion-dollar acquisitions. Today, it's different. The Street, ever fee-hungry, has brought forth lawyers and investment bankers to handle ever-larger deals. And, naturally, to knock down ever-growing fees. Salomon Brothers got $29.6 million in the Gulf deal, Morgan Stanley got $16.5 million and Merrill Lynch got $18.9 million. Kidder, Peabody got $15 million when Carnation was sold to Nestlé. Goldman, Sachs got $18.5 million in Getty's sale to Texaco, the same deal in which First Boston Corp. got $10 million for four days' work.

"People have learned to do things quickly," says Charles Nathan, managing director of strategic services at Merrill Lynch Capital Markets, who worked on his first merger deals as a young associate in the Wall Street law firm of Cleary, Gottlieb, Steen & Hamilton in 1968. "I remember negotiating an acquisition where the burning issue was whether the seller could provide us with a list of all the leases, including the ones on the typewriters," he says. "Now people are making multibillion-dollar decisions on the basis of nothing but public information. It used to take weeks to line up bank commitments. Now it can be done in just a few days."

Ten years ago First Boston Corp.'s mergers and acquisitions department consisted of 4 people and a telephone. Today it has 110 people. At the New York law firm of Skadden, Arps, Slate, Meagher & Flom, takeover business has tripled in the past ten years, and the number of partners working on it has doubled. Hungry, smart, highly paid people sit around all day doing deals or dreaming them up. This is where the action is. "There's a fever," says Martin Sikora, editor of *Mergers & Acquisitions* magazine. "Up until a few years ago M&A was an opportunistic thing. Now companies have long-term strategies to grow by making acquisitions."

Assets for sale

In 1968, with stocks worth an average of 1.5 times assets, acquisitions were made with stock. The current takeover wave began in 1974. It's easy to see why.



*Estimate, †Estimated range.
Sources: Through 1982, U.S. Council of Economic Advisers, 1983 and 1984, George von Furstenberg, Indiana University.

It was less than six years ago that IBM sold the first $1 billion issue of corporate bonds, amid worries that the market couldn't absorb such a huge offering; today Drexel Burnham floats $1.3 billion of junk bonds for Metromedia, and no one blinks. Until 1975 there had been only one billion-dollar corporate acquisition in history, Xerox' purchase of Scientific Data Systems in 1969. There have been 40 in the past four years, 17 of them last year alone. Even taking inflation into account, last year was the biggest ever for the dollar amount of acquisitions, exceeding the previous high set in 1968 *(see chart, opposite page)*.

The current merger wave, the fourth since the late 1890s, began in 1974 when old-line International Nickel Co., advised by old-line Morgan Stanley & Co., successfully raided another old-line industrial company, ESB. (Inco won, which is to say it lost, and ended up losing a lot of money, but that's another story.) If stodgy Inco and Morgan Stanley could do it, then hostile takeovers had become respectable.

When the wave started, companies such as United Technologies used acquisitions to expand more quickly and cheaply than they could by building businesses from scratch. By comparison with what is happening today, that was a reasonably respectable motive. In recent years much of the activity has changed from cheap expansion to quick asset liquidation and to companies trading businesses. CIT Financial and Utah International have both changed hands twice. Esmark bought Norton Simon and sold businesses to help pay for it, then sold itself to Beatrice Cos., which is selling businesses to help pay for buying Esmark.

The previous merger waves were from 1896 to 1904, when monopolies like U.S. Steel and Standard Oil were formed in reaction to the Sherman Act, which outlawed

trusts but not monopolies; from 1919 to 1929, when companies like General Motors, Swift and Pullman bought up suppliers and expanded horizontally; and from 1960 to 1969, when conglomerates used their overpriced stock to buy other companies and manipulate their earnings.

Raiders argue that today's deals take place because of the disparity between what they are willing to pay for assets and the meager profits that incompetent corporate managers earn from them. In some cases, the argument that a low stock price-to-asset ratio reflects bad management is compelling. But almost all stocks carry lower P/Es than they used to. The average P/E of the Standard & Poor's 500 is now 11, compared with the 18 that it was 20 years ago. Have the managers all gotten 40% less competent since 1965? Did Inco's takeover make ESB a better company or a worse one? Did Mobil make Montgomery Ward better or worse? One needn't be a close student of business to realize that these takeovers resulted in worse management, not better.

To the extent that the leadership of American business is deficient in zeal and ability, the takeover artist is a questionable replacement. The leading predators like to portray themselves as champions of the shareholder and enemies of slothful management. But this pose is so self-serving as to be ridiculous. If many stocks still sell at low multiples compared with previous years, the reason is much more likely a consequence of high interest rates rather than of lousy management. With long-term interest rates running double the level they were at 20 years ago, why should any rational investor pay as much for a dollar of corporate earnings as he was willing to pay when rates were at 5% or 6%?

High interest rates lower the value of a dollar of earnings. At the same time, the inflation of the 1970s was steadily increasing the value of a dollar of assets. Earnings—what most investors react to—were worth less, while the underlying assets were worth more. The situation was ready-made for raiders and liquidators who knew how to buy on the basis of earnings and how to sell on the basis of assets.

In any event, totally awful companies are rarely taken over. "When you're an ugly girl, no one pays attention to you," says John Norell, president of Phillips' biotechnology subsidiary. "Then she gets herself in shape . . . and the first thing that happens is, somebody rapes her." As a result, companies are sometimes led to doing perverse things to avoid rape. They may overpay for an acquisition in order to make themselves less sexy to potential rapists. Or they may load up their balance sheet with debt to make themselves less attractive.

"The whole game is nauseating," says Andrew Sigler, CEO of Champion International and chairman of the Business Roundtable's corporate responsibility task force. Sigler, whose company recently became the biggest paper company in the world by acquiring thrice-greenmailed St. Regis Corp., complains that whenever he expands Champion's capacity, he's deluged with complaints that all he cares about is making paper, not making money for his shareholders.

"The problem is deciding who the hell the corporation is responsible to," he says. "I can't ask my shareholders what they want. Champion is 75% owned by institutions, and my shareholders change so damn fast I don't even know who they are." And, he adds, "We're owned by a bunch of index funds. Who votes for an index fund? Some damn mathematical formula votes your stock."

Once a company is attacked, it is all but doomed to lose its independence if the raider succeeds in putting his offer into effect, because money managers, who control two-thirds of U.S. stock trading volume, tend to take the money and run.

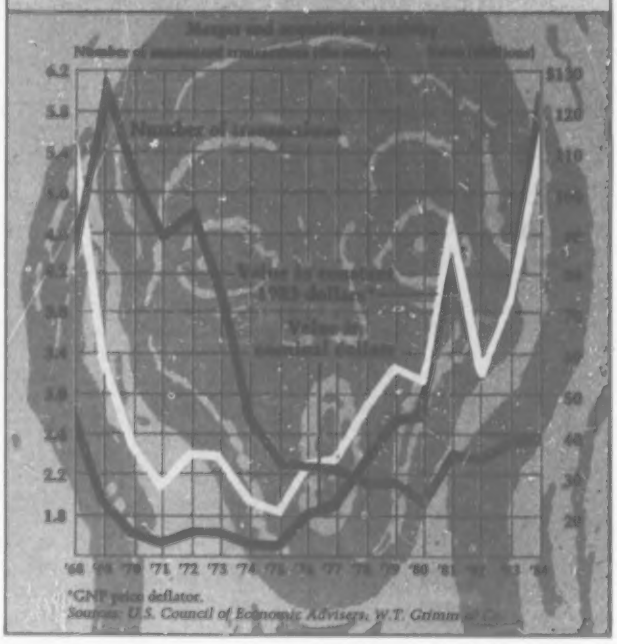
Smile, then, when one of these raiders proclaims himself an apostle of shareholder value. They claim they want to help the target company's shareholders maximize returns. But when the target company pays greenmail—and the raider, naturally, accepts it—it is the shareholders the raider professes to care about who ultimately pay the bill. If a company is taken over and liquidated at immense profit, didn't that profit belong rightly to its shareholders? The idea that most of these raiders are out to maximize value for anyone other than themselves is ludicrous.

A FORBES study suggests that patient investors can be better served by having a tender offer fail rather than succeed. We studied 39 cases assembled by Kidder, Peabody & Co. (which specializes in tender defense) in which companies defeated hostile tender offers and remained independent. We compared what stockholders earned by holding these stocks through the end of 1984 (or until another bidder bought the company) with what they would have earned had the tender been successful and the proceeds reinvested in the S&P's 500 Index.

In 17 cases the target company's stock outperformed the index, sometimes by 3 or 4 to 1. So in almost half these cases, money managers would have maximized profit by holding shares rather than tendering them. We chose cases at least two years old to give the target stocks a reasonable period to make up lost ground, compared with what the tender offer would have yielded *(see table, p. 139).*

Counting the deals

Today's takeover lunacy involves fewer deals than earlier periods of excess, but far more money. Even counting inflation, 1984's dollar total topped 1968's.



One megamerger that has been an unqualified financial success is Allied Corp.'s famous takeover of Bendix Corp. You remember that bizarre 1982 battle, of course. First, Bendix went after Martin Marietta Corp. Then Marietta counter-tendered for Bendix and got United Technologies to go partners on the deal. Bendix and Marietta bought majorities of each other. Allied Corp. came out of nowhere to settle things by buying all of Bendix and 39% of Marietta.

What made the deal work was asset stripping. Who would have thought that Bendix, a $4.1 billion (revenues) automotive parts, aerospace and machine tool conglomerate, was an asset play? Allied CEO Edward Hennessy Jr. did. Hundreds of Bendix headquarters employees have lost their jobs, and the work force at Bendix plants in Cleveland and South Bend, Ind. has been slashed, but Bendix has become the most profitable part of Allied.

Allied spent $1.8 billion in cash, notes and stock to buy Bendix. Within a year, Allied generated:

- $343 million from selling Marietta back its shares;
- $129 million from selling RCA stock that Bendix owned;
- $90 million from liquidating Bendix Automation, formerly one of the largest machine tool companies in the nation;
- $47 million from selling Bendix' portfolio of bank preferred stocks;
- $33 million from selling Bendix' Gradall earthmoving machine and Texas Pipe Bending businesses;
- $25 million from selling most of Bendix' headquarters building in Southfield, Mich.

Michael Wilso

White knight Edward Hennessy Jr.

These sales raised $667 million. Allied says it took another $190 million of cash out of Bendix by reducing inventory levels and cutting down receivables. That totals $857 million of cash stripped out.

Then there were tax synergies. In the past, Bendix, with a hefty U.S. tax bill, purchased tax credits. Allied, plagued with capital-intensive, low-profit U.S. businesses, sold some unused tax credits. Allied had some $100 million of tax carryforwards when it bought Bendix. Allied won't say how much it netted because "we would rather not draw attention to it." Let's be conservative and say that $43 million was realized by tax games. That would raise the cash taken out of Bendix to $900 million.

But only $925 million of the $1.796 billion that Allied paid for Bendix was in cash. The rest consisted of original issue discount notes ($249 million at the date of issue), preferred stock ($276 million) and 22.9 million common shares ($446 million at date of issue).

Taking out $900 million got Allied back almost all of its cash. The asset sales reduced Allied's net investment in Bendix to $900 million—the purchase price less cash stripped out. In 1983 Allied recorded an $80 million loss on Bendix, increasing its net Bendix investment to $980 million. In 1984, after subtracting corporate overhead, preferred stock dividends and interest on the notes, Allied earned about $185 million on its Bendix investment. Divide that by the $980 million and you have a 19% aftertax return on invested capital. That would be the equivalent of Allied's having paid a price/earnings multiple of 5.3.

Dividing the 22.9 million Allied shares issued in acquiring Bendix into the $185 million Bendix earned produces income of $8.10 a share. If you subtract the Bendix profits and the 22.9 million shares from Allied's year-end numbers, Allied would have earned only about $3.80 a share. With Bendix, it earned $5.03.

Look at it another way. The 1984 earnings and the $220 million that Allied expects Bendix to earn in 1985 just about pay for the notes and preferred stock that Allied issued to buy Bendix. Two more $220 million profit years would pretty much cover the cost of the common stock, and Allied would then own Bendix for nothing.

"Not many acquisitions turn out this well," says Harold Burkle, Allied's executive vice president-administration. "In our acquisition economics we were more conservative than we expected things to be, and they've turned out better than we expected."

Allied got lucky, to be sure. Marietta redeemed its stock earlier than expected because its stock price shot up and it was able to resell to the public the shares it bought from Allied. Bendix' automotive parts business did much better than expected, too.

But Allied was more than lucky—it was smart. Bendix CEO William Agee congratulated himself on getting shareholders the highest price Bendix shares had ever fetched. In reality, of course, Ed Hennessy got Bendix cheap. Which shows that although takeovers may not be great for the country as a whole, there's a lot of money to be made in them if you're smarter than the other guy.—A.S.

But few CEOs can ask shareholders to reject a tender offer and wait for two years. In the meantime the question that plagues hundreds of conscientious chief executives is the question asked on our cover: Is there no escape from these people?

To beat takeover artists to the punch, CEOs can do what raiders would do: sell off real estate that's undervalued on the books or recover the surplus from overfunded employee pension funds. Those are probably good long-term strategies, regardless of whether a company is a target. In fact, many of the mergers that have been financially successful involved one corporation asset-stripping the other *(see box, opposite)*.

This liquidating of assets is part and parcel of the deindustrialization of America. Things are changing so fast these days that a CEO who doesn't do these obvious things—distasteful as they may be—can find himself thrown out and an acquirer buying the company and liquidating these assets to his personal profit, rather than for the benefit of the shareholders.

CEOs who feel that their shares are undervalued can leverage the company or liquidate all or part of it themselves, giving the profit to their shareholders rather than allowing a raider to seize it. Classic examples are Teledyne, which has periodically borrowed money to offer shareholders a chance to sell at an above-market price; IU International, which spun off its Echo Bay gold mine to its shareholders; or Masonite, which distributed its timberlands to its shareholders.

Many companies contend that the need to keep stock prices up forces them to take short-term approaches to their business. Their argument is that the Carl Icahns and Irwin Jacobses are turning this country over to the Japanese, who lack such predators.

But it's not as if corporate managers all thought long term until 1981, when big companies began to fall prey to raiders in record numbers. CEOs have been happy to base bonuses on short-term results, to reward money managers and employees for what they did in a quarter, to eschew long-term investments because they can't earn some mystical "hurdle rate" that is double or triple what the company as a whole earns. In other words, many companies are vulnerable to the predators precisely because they have managed for short-term results for too long. Companies like IBM, which managed for the long term, have little to fear.

"If you take a list of the best-run companies, they typically make long-term commitments, and they sell at decent multiples," says Frederick Joseph, head of Drexel Burnham's corporate finance department. "IBM is not a target. ITT is a target, because it hasn't managed its businesses very well. So ITT is complaining that it can't plan long term because of the sharks."

Rather than worrying about maximizing return on investment or long-term prospects, many companies take the easy way out—they pay off predators to go away. You can't blame predators for taking the money and acting like predators—they're not public charities, they're in business to make money any way they can, short of breaking the law. Blame the companies making the payoffs. But as the late Neville Chamberlain found out, appeasement doesn't work. Hitler promised to behave if they would let him take the Sudetenland, but he came back later for Poland and France.

After a greenmail payment, a company's stock tends to plunge as takeover speculators bail out—and someone like Irwin Jacobs, with a shrewd eye for market overreactions, may well appear. Jacobs bought into Avco, Disney and

Maximizing shareholder value?

Conventional wisdom notwithstanding, a target's shareholders are often better off if a tender offer fails. We studied 39 cases in which companies successfully resisted hostile tenders. In 17 cases, the value of the target's stock at year-end 1984 exceeded what a shareholder would have if the offer had succeeded and the proceeds had been reinvested in the S&P's 500 Index. (Where a company defeated one offer but was later bought, our calculations run through the acquisition date.) So when managers call an offer for their company "inadequate," it's not always just to protect their jobs. We didn't include capital gains tax on the tender proceeds and didn't count cash dividends from the stock or the S&P's.

Company	First announcement date	How well you—would have fared—holding stock through 12/31/84	investing proceeds in S&P's 500
Dictaphone*	Sep 1974	133%	33%
Inspiration Consol Copper*	Feb 1975	–16	17
Sterndent*	Feb 1975	61	49
Unitek*	May 1976	97	–7
Pargas*	May 1976	143	58
McKesson	May 1976	42	61
Sabine and Sabine Royalty Trust	Sep 1976	135	62
Universal Leaf Tobacco	Oct 1976	389	63
Viacom International	Jan 1977	225	73
Sunshine Mining	Mar 1977	36	69
Detroit Intl Bridge*	May 1977	25	14
Gerber Products	Aug 1977	51	73
Marshall Field*	Dec 1977	–29	24
Rowan Cos	Jul 1978	47	61
Mead Corp	Aug 1978	–2	62
Wurlitzer	Sep 1978	–85	73
Levitz Furniture	Nov 1978	172	73
Chicago Rivet & Machine	Jan 1979	–44	73
Mission Insurance*	Jan 1979	29	64
McGraw-Hill	Jan 1979	114	73
Ludlow Corp*	Feb 1979	45	18
Woolworth	Apr 1979	6	69
Hoover	May 1979	31	64
Harnischfeger	Jun 1979	–60	61
Morrison Inc	Jul 1979	–3	56
Telecom Corp	Aug 1979	–87	54
Gulf Resources	Feb 1980	–70	64
Harsco	Jan 1981	26	47
Amax	Mar 1981	–79	26
Canal-Randolph (in liquidation)	May 1981	229	29
Posi-Seal Intl	Jun 1981	–32	28
Heinicke Instruments	Jul 1981	–14	36
Wetterau	Aug 1981	19	43
Grumman	Sep 1981	21	37
Maxxam Group	Oct 1981	11	33
Brunswick	Jan 1982	352	48
SCA Services*	Mar 1982	99	42
RP Scherer*	Jul 1982	48	44
Martin Marietta	Aug 1982	39	37

*Acquired before 12/31/84; results through acquisition date.

Everyone is preparing for the takeover wave to go on forever, but it won't. The market created these raiders, and market forces will ultimately make them go away.

Castle & Cooke after they were greenmailed but hasn't taken any greenmail himself. "I think greenmail is terrible," he says, "but if it's not stopped, I'm going to do it. . . . My objective is to make money." The sad thing is that it would be so easy to stop greenmail. Just pass a law forbidding companies to make any offers to big stockholders that they don't offer to all their stockholders.

So far, according to statistics compiled by Kidder, Peabody, five companies have adopted antigreenmail charter amendments, and about 60 more will probably have them in place by the middle of this year. Last year alone, 250 companies installed various antitakeover provisions. Everyone is preparing for the takeover wave to go on forever.

But it won't. The House, Senate and SEC are all holding yet another set of hearings on takeovers. Previous reform attempts produced only minimal changes such as taxing some "golden parachute" payments. Now the business establishment is after major revisions. "The people in the merger business want to modify the rules by taking out the nauseating things like golden parachutes and scorched earth defenses," says Champion's Andy Sigler. "They don't want to stop the game. That's how they make their living."

Even if Congress does nothing about takeovers, the market may. Some takeovers seem in financial trouble: For one, Victor Posner's hostile buyout of Royal Crown resulted in missed bank loan payments, since made up. One or two horrible failures will cut back bank takeover money in a hurry. The proposed tax law changes would lower corporate tax rates to 33% from 46%, decreasing the value of interest deductions, and would greatly reduce the 1981 tax breaks.

Moreover, the stock market is strong. And with inflation having subsided to low levels, no longer do asset values increase 10% a year automatically. As stock prices more closely reflect basic asset values, the predators will lose their easy prey.

No other major merger wave has gone on for more than ten years. This one is already well advanced. We suspect that just as they begin to look unstoppable, the financial raiders will either disappear from the scene or metamorphose into conventional businessmen. ■

Mortgaging the future

When companies start worrying about sharks, practically the last thing they care about is tomorrow. As a result, one of the first items to go in corporate restructurings is the R&D budget. Long-range planning is pushed to the back burner when companies attempt to thwart current takeover attempts, according to Michael Heylin, editor of *Chemical & Engineering News*, which is published by the American Chemical Society. Aside from the scientists and engineers who are laid off, R&D dilution demoralizes everyone in a company because they suddenly realize that long-range thinking and planning have gone by the board. Consider: Between June 1982, just prior to the first assault on the company by T. Boone Pickens, and now, Gulf Corp. throttled back operations including its research and development. According to one source, a substantial number of its scientists and engineers have been laid off. Did it help? Chevron Corp., which took over Gulf in June of 1984, has continued the cuts. Gulf's once-respected research institute, in Harmarville, Pa., will probably soon be sold or donated to the University of Pittsburgh.

The case is much the same with Phillips Petroleum. In opposing Boone Pickens and Carl Icahn, Phillips came up with a refinancing and asset sale scheme designed to produce at least $2 billion. To raise that money, says John Norell, president of Provesta Corp., Phillips' biotechnology subsidiary, research expenditures have been slashed by 75%, from more than $20 million to $5 million. While no scientists have yet been laid off, Norell says that substantial numbers of scientific and technical jobs would be threatened if assets were sold. In addition, advanced research projects already on the drawing boards, such as a $15 million dry yeast protein plant in Nebraska, have been scrubbed, and the company is scaling back on venture capital commitments made to fledgling companies.

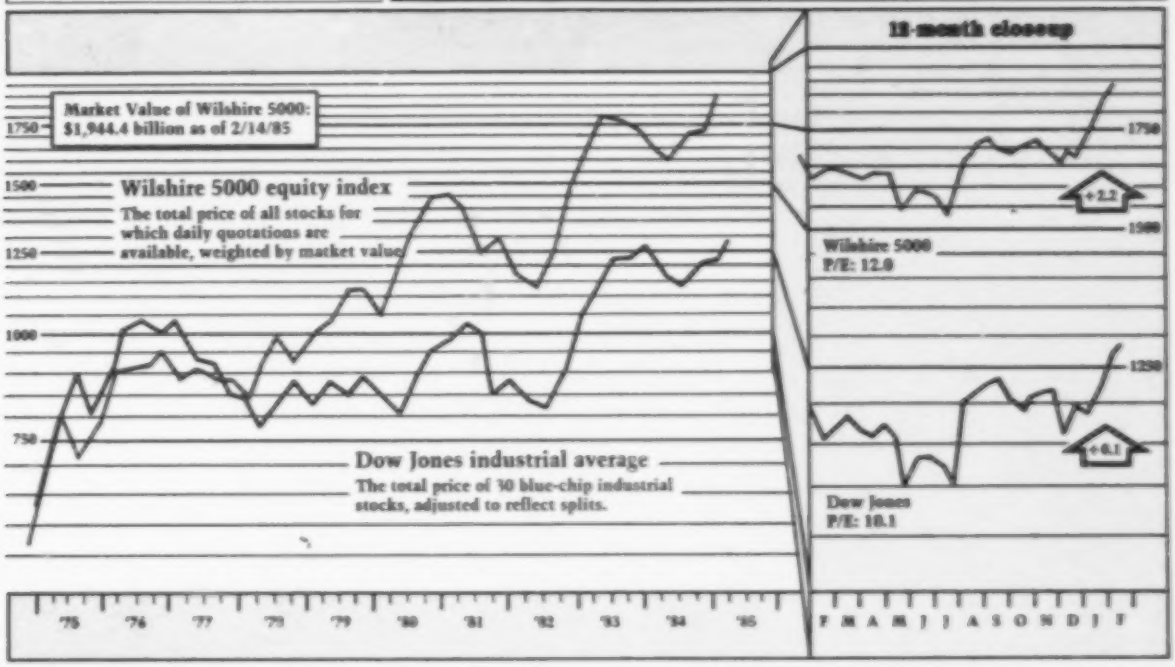
At a recent meeting of the Industrial Biotechnology Association in Fort Lauderdale, Norell made it clear to companies such as Biogen, Cetus and Genentech, which are now looking to the oil and chemical giants as joint venture partners: "It won't be easy to walk into a large company to get money. For the short term, spare cash in our industry is going toward the redeployment of existing assets."

Why would any company in its right mind do away with R&D in an increasingly competitive environment? Says Norell, "Everybody figures, hell, let's just get past today. Research is intangible, and there is little way we can prove that it benefits the company immediately. So we can save money by firing the scientists, and when this is all over we can just hire them back."

But it isn't that simple. Work in progress that is suddenly terminated is often superseded by more advanced research elsewhere. So what appears to be a short-term savings turns out to be not a long-term but an almost immediate loss.—**Stephen Kindel**

Edited by Steve Kichen

The Forbes/Wilshire 5000 Review


Market Value of Wilshire 5000: $1,944.4 billion as of 2/14/85
1750
1500
1250
1000
750
Wilshire 5000 equity index
The total price of all stocks for which daily quotations are available, weighted by market value
Dow Jones industrial average
The total price of 30 blue-chip industrial stocks, adjusted to reflect splits.
'75 '76 '77 '78 '79 '80 '81 '82 '83 '84 '85
12-month closeup
1750
1500
1250
+2.2
Wilshire 5000
P/E: 12.0
+0.1
Dow Jones
P/E: 10.1
F M A M J J A S O N D J F

Real and wonderful. The market demonstrated its ability to lunge back from a one- or two-day selling spree in the last few weeks. Toward the end of the recent two-week period, a day's trading on the Dow crossed the 1300 line. This 30-stock average closed this session a whisker short of that level, but still at an alltime high. The Wilshire index of more than 5,600 issues also hit a peak during the same day. Late profit-taking cut the Dow's gain to just 0.1% for the two-week period and a 4.8% gain for the last four weeks. Meanwhile, the Wilshire registered a 2.2% advance over the two-week stretch and a 7.6% gain for the four-week period. Over the last 20 trading days the Wilshire has added more than $138 billion in market capitalization. Both Amex and NASDAQ issues are up more than 3% for the last two weeks and 10% or more for the last four weeks.

The Wilshire index now stands 17.3% higher than it did one year ago, while the Dow industrials are up 11.5% and the Forbes 500, 18%. Since the beginning of the year it has been hard for the average investor to go wrong. Some analysts are talking about a Dow soon reaching hundreds of points higher than it is now. But a market rally is no excuse for indiscriminate action. A rising tide doesn't lift boats with holes in them.

Close-up On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[1]	Dow Jones industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	7.6	7.3	4.8	7.0	10.0	10.4
in last 52 weeks	17.3	18.0	11.5	17.7	12.1	14.5

Stock performance based on six key investor yardsticks

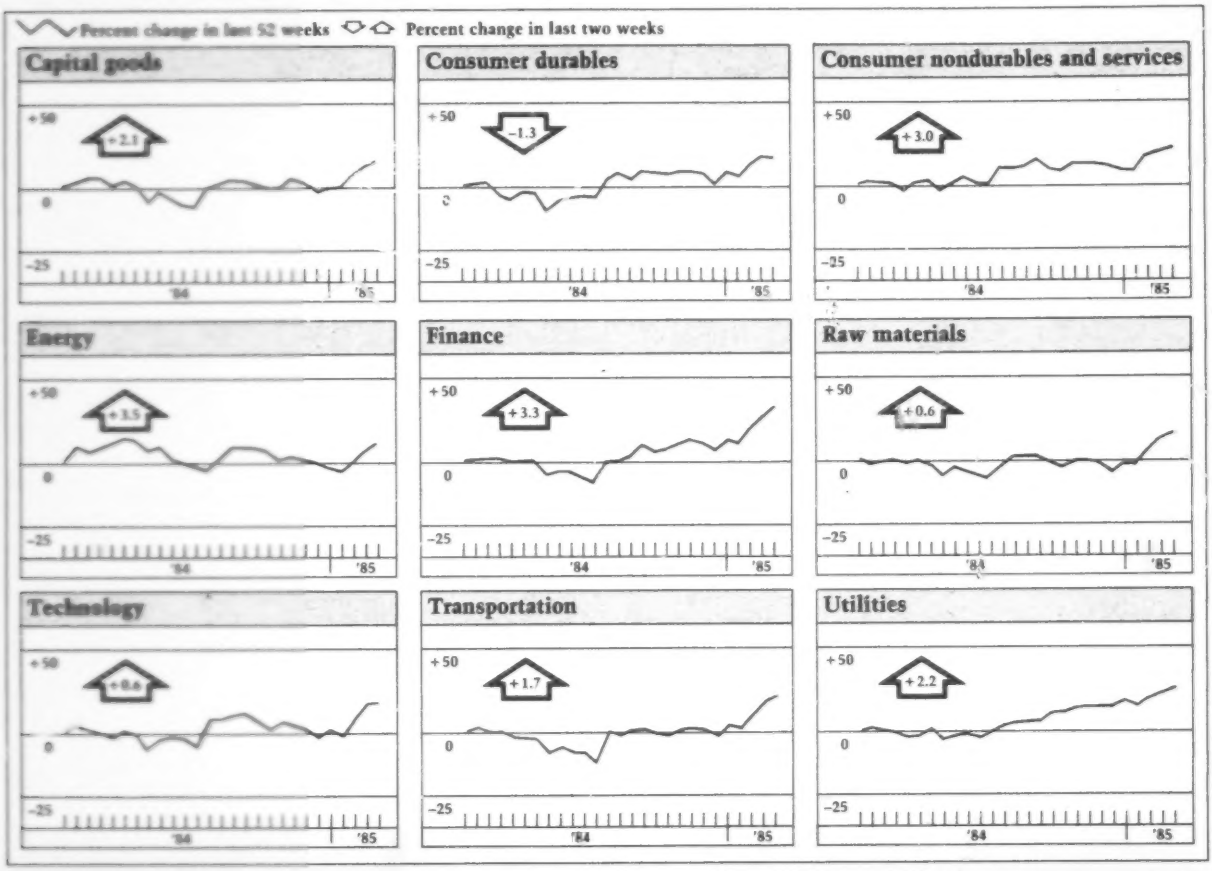
Percent change	Company size		Volatility[2]		P/E multiple		Dividend yield		Growth profile[3]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	7.6	12.6	18.1	6.0	11.9	9.8	5.8	16.8	15.0	6.5	7.5	14.7
in last 52 weeks	19.5	12.2	17.1	25.0	6.1	26.6	21.3	16.8	13.8	24.5	23.5	3.8

[1]Based on sales.
[2]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable.
[3]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 2/14/85. Prepared by Wilshire Associates, Santa Monica, Calif. Kenneth Alcorn

Where The Action Is

Playing favorites again. The market has been advancing across a wide front, but during the last two weeks investors began searching for favorite rally groups. Energy shares show the best performance during this stretch, a 3.5% gain, but at least part of the activity in the oils stems from the unfolding Phillips drama. Finance stocks had the second-best gain, a 3.3% rise. Consumer nondurables issues were up 3%. But consumer durables stocks declined 1.3%, and raw materials managed only a 0.6% advance. A rallying market can turn against an individual stock with a vengeance at the slightest drop of bad news. Data General, for one, was haunted by a loss of close to 20 points in less than a week. Other computer issues suffered, and the technology sector gained only 0.6%.



What The Analysts Think

Winners and losers. With both the market and the economy rallying, analysts raised their 1985 earnings projections for the finance sector (brokerage houses and banks) and consumer durables sector (auto industry). But recent disappointments in the computer industry prompted some estimate-cutting for the technology stocks.

Forecasting the Forbes 500

Performance period	Average earnings per share	P/E
latest 12 months	$3.79	10.4
1985 estimates	4.50	8.7
1986 estimates	4.84	8.0

Rank based on change in estimate	Sector	Estimated 1985 EPS	Estimated 1985 P/E	% change in 1985 estimate in 2 weeks	% change in 1985 estimate in 4 weeks
1	Finance	$3.44	8.5	0.24%	0.19%
2	Consumer durables	5.09	7.8	0.04	0.13
3	Utilities	3.63	7.1	–0.19	–0.20
4	Capital goods	3.09	10.4	–0.34	–0.32
5	Transportation	3.34	8.1	–0.54	–0.72
6	Consumer nondurables	2.74	10.3	–0.68	–0.88
7	Energy	3.85	7.1	–1.04	–1.40
8	Raw materials	2.68	8.7	–1.43	–2.24
9	Technology	3.16	10.6	–1.87	–2.09

Earnings projections are capitalization-weighted consensus estimates from over 2,000 security analysts. Data are compiled and updated continously by the Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan, a New York-based brokerage firm.

Note: All data for periods ending 2/14/85. Prepared by Wilshire Associates, Santa Monica, Calif., IBES, a service of Lynch, Jones & Ryan, New York.

Statistical Spotlight

With the Dow up more than 175 points since last summer, we couldn't resist peeking at our computer-picked test portfolios.

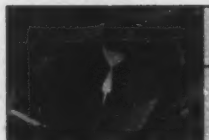
Smart darts revisited

By Leslie Pittel

HOW GOOD ARE simple computer programs at picking stocks? Sometimes, very good. Usually they are just average. Such are the early indications from five computer-generated portfolios published here last July.

This game goes back to 1967, when we took a whimsical look at the random walk theory, the notion that investment analysis can't beat guesswork in picking stocks. Three FORBES executives selected 28 stocks by dart throws. But, thanks to mergers and liquidations, the list dwindled to 15, and we finally put our portfolio to rest (FORBES, *July 30, 1984*). It had bested the Dow by more than 10-to-1.

We replaced our original dart board with the Smart Dart Fund of 25 stocks selected by a microcomputer. And, again with some help from our com-



The early leader: The Pure Play Price/Earnings Fund

"Contrarians" say they can beat the market by buying out-of-favor stocks with low multiples. This test portfolio of low-P/E issues is up 27.2% since last summer, assuming equal dollar investments in each stock.

Company/business	Price recent	Price original*	Price % change	Latest 12 months EPS	Latest 12 months P/E	Yield	Book value	Estimated EPS 1985
American Century/real estate	10⅜	8	30%	$0.90	11.5	—	$6.63	$2.00
Central Maine Power/electric utility	10⅜	11⅛	–7	2.64	3.9	13.5%	16.68	2.42
Chase Manhattan/bank holding	55	39⅛	39	9.01	6.1	6.9	91.02	10.62
Chemical New York/bank holding	41	25¾	59	6.48	6.3	5.8	45.77	6.65
Cincinnati Gas & Elec/utility	15¼	11	39	2.45	6.2	14.2	20.24	2.47
Commonwealth Energy/utility	28¾	19⅜	48	4.75	6.1	8.1	23.58	4.18
Consumers Power/electric utility	6¼	6⅛	2	1.66	3.8	—	25.92	1.46
Contl Illinois/bank holding	5½†	5⅜	–2	NA	NA	NA	NA	NA
DWG/propane gas	2⅝	2¾	–4	0.36	7.3	—	5.51	1.00
El Paso Electric/electric utility	14½	10½	38	2.88	5.0	10.1	13.41	2.85
Finl Corp America/savings and loan	10	11¾	–15	–1.09	NM	2.0	NM	2.31
First Am Finl/title insurance	31	25	24	6.34	4.9	2.3	29.22	7.00
First Western Finl/savings and loan	6¾	6¼	8	1.23	5.5	3.0	NM	1.77
Ford Motor/auto	46⅜	35½	31	16.19	2.9	5.4	50.43	14.88
Gibraltar Finl/savings and loan	9¾	6⅞	42	2.05	4.8	—	9.75	2.21
Golden Western Finl/savings and loan	26½	11⅞	123	3.91	6.8	0.8	NM	4.22
Kansas Cty Pwr & Lt/electric utility	21⅛	15	41	4.49	4.7	11.2	23.46	4.15
Long Isl Lighting/electric utility	8¼	5⅜	53	3.01	2.7	—	19.28	2.90
Maine Public Svc/electric utility	16⅛	15⅞	2	5.12	3.1	8.7	37.04	4.95
Manufacturers Hanover/bank holding	40¼	25⅜	59	7.12	5.7	8.0	63.62	8.04
Middle South Utils/electric utility	14⅜	11	31	2.76	5.2	12.4	18.19	2.59
Public Svc Ind/electric utility	8⅛	8⅝	–6	2.07	3.9	12.3	27.24	1.11
Public Svc New Hamp/electric utility	4⅞	5⅛	–5	3.07	1.6	—	20.24	3.32
Toledo Edison/electric utility	18½	15⅛	22	3.70	5.0	13.6	24.09	3.56
United Illuminating/electric utility	16⅞	13⅛	29	5.40	3.1	11.9	31.48	4.95

*As published in FORBES, July 30, 1984. †Recent value represents 1 share of Cont'l. Hldg. and 1 right to new Cont'l. Illinois. NA: Not available. NM: Not meaningful.

Sources: Wilshire Associates; Standard & Poor's Stockpak-II System; The Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan; FORBES

puter, we created four other groups, each based on a simple version of an accepted stock-picking principle. The Pure Play Price/Earnings Fund consisted of 25 shares with the lowest price/earnings ratios. The Pure Play Book Value Fund contained 25 issues selling at steep discounts from book value. The Pure Play Growth Fund consisted of firms with high sales and earnings growth over the past four years. And the Pure Play Analysts' Choice Fund was 25 stocks whose anticipated 1985 earnings would show the largest gains over 1983's.

Second place: Pure Play Growth Fund

With a 19.5% gain, this portfolio beat the Dow, up 15.6%, but not the Wilshire index, up 20.6%.

Company/business	Price recent	Price original*	Price % change	Latest 12 months EPS	Latest 12 months P/E	Yield	Book value	Estimated EPS 1985
Academy Insur Grp/insurance	10⅜	8¾	19%	$–0.65	NM	1.9%	$4.14	$1.22
Amfesco Inds/footwear	15¼	12¾	20	2.33	6.5	—	9.57	NA
Avant-Garde Computing/software	18	19⅛	–6	0.57	31.6	—	5.12	1.10
Berg Enterprises/mortgage banking	16⅜	9	82	1.64	10.0	—	4.93	1.67
BR Communications/electronics	12¼	16¾	–27	1.19	10.3	—	6.38	1.25
Comair/airline	16	10	56	1.03	15.5	—	7.03	2.13
Commodore Intl/computer equip	13⅜	28⅞	–54	4.77	2.8	—	10.56	3.46
CPI Corp/industrial svcs	18	18⅞	–5	1.47	12.2	—	4.60	1.74
Dreyfus/financial svcs	48¾	26¾	82	3.53	13.8	2.1	11.36	3.94
Dysan/computer equip	14⅜	10	44	–1.80	NM	—	9.82	0.07
First Executive/insurance	14⅜	10⅞	32	1.10	13.1	—	9.78	1.42
General Homes/building	8¾	6½	35	0.72	12.2	—	8.91	0.67
GTS/oilfield svcs	11	7⅞	40	1.10	10.0	—	2.91	1.50
Gulfstream Aerospace/aerospace	16½	15⅞	4	1.67	9.9	3.3	6.67	1.47
Helen of Troy/cosmetics	8¾	7	25	0.71	12.3	—	3.58	1.07
Jeffrey Martin/cosmetics	8	6½	23	0.60	13.3	—	1.61	0.70
Key Pharmaceuticals/ethical drugs	11⅝	12½	–7	0.62	18.8	1.7	1.67	0.85
Limited/retail	37¼	19	96	1.38	27.0	0.6	4.10	2.02
Liz Claiborne/apparel	30¾	19¼	60	1.77	17.4	0.8	4.46	2.38
Phoenix American/financial svcs	3¾	6¼	–40	1.00	3.8	—	2.22	0.82
Provincetown-Boston Air/airline	4½	9	–50	0.48	9.4	—	4.38	0.80
Quick & Reilly Grp/securities brokerage	24¾	16½	50	1.23	20.1	0.8	6.64	1.60
Southern Hospitality/restaurants	5¾	3⅞	48	0.35	16.4	—	2.22	0.65
Yankee Cos/integrated oil	7½†	9⅛	–18	1.15	6.5	—	3.82	0.66

*As published in FORBES, July 30, 1984. †Formerly Yankee Oil & Gas. NA: Not available. NM: Not meaningful.

Sources: Wilshire Associates; Standard & Poor's Stockpak-II System; The Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan; Forbes

The Smart Dart Fund, up 18.1%

These 25 shares, picked randomly by computer, beat the Dow and the analysts. But they couldn't top the Wilshire.

Company/business	Price recent	Price original*	Price % change	Latest 12 months EPS	Latest 12 months P/E	Yield	Book value	Estimated EPS 1985
American Sterilizer/health care equip	22½†	16¼	38%	$1.51	14.9	—	$14.18	$1.55
Ampad/paper products	19¾	14½	36	1.23	16.1	2.0%	6.90	1.50
ArgoSystems/electronics	21¾	17	28	0.95	22.9	—	4.90	1.02
Bellwether Explor/oil and gas expl, dev	2⅜	3¼	–27	0.22	10.8	—	1.97	0.50
Big Bear/grocery stores, retail	12¾	9½	34	1.63	7.8	—	8.16	1.85
Burndy/electronics	17¾	15	–17	1.07	16.6	4.7	10.86	1.28
Dreyer's Gr Ice Crm/ice cream	19	18¼	4	0.91	20.9	—	4.12	1.15
AG Edwards/securities brokerage	33⅞	22¼	52	1.49	22.7	2.4	13.61	2.46
Forest Labs/drugs	20	15	33	0.57	35.1	—	5.54	1.35
Home Centers of Am/home products	11†	9⅝	14	NM	NM	NM	NM	NM
Infodata Systems/computer software	3⅜	7½	–55	–1.35	NM	—	2.54	0.65

The Smart Dart Fund, up 18.1%

Company/business	Price recent	Price original*	Price % change	Latest 12 months EPS	Latest 12 months P/E	Yield	Book value	Estimated EPS 1985
Intl Banknote/printing	3¼	4⅜	–26%	$–1.43	NM	—	$ 0.89	$ 0.36
Iomega/computer equipment	11⅝	5⅛	129	9.00	NM	—	1.40	0.94
Penn Central/multicompany	53½	46	16	4.45	12.0	—	39.63	3.88
Rainier Bancorp/bank holding	24⅞	18	36	3.13	7.9	4.0%	21.99	3.49
Richardson-Vicks/cosmetics	29	26⅜	10	3.15	9.2	5.1	11.96	3.08
Sandwich Chef/fast food	8¾	7½	17	0.61	14.3	—	5.87	0.78
SIS Corp/fast food	5	6⅜	–22	NA	NA	—	NA	0.35
Steiger Tractor/agricultural equip	7⅛	8	–11	0.03	NM	—	10.24	0.39
Texas Am Bancshares/bank holding	37¼	37½	–1	4.06	9.2	4.1	33.84	4.72
Time/publishing	50½	40½	25	3.37	15.0	1.6	12.50	3.71
Toro/appliances	16½	11¼	47	1.48	11.1	1.2	8.93	1.46
Ultrasystems/engineering, construct	8¼	18½	–55	0.93	8.9	0.7	5.69	1.26
Victoria Bankshares/bank holding	23½	21	12	1.80	13.1	4.3	21.00	2.00
Winnebago/recreational vehicles	20½	10¼	100	1.16	17.7	0.5	4.84	1.55

*As published in FORBES, July 30, 1984. †Went private. ‡Acquired by K mart. NA: Not available. NM: Not meaningful.

Sources: Wilshire Associates; Standard & Poor's Stockpak-II System; The Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan; Forbes

The Pure Play Analysts' Choice Fund

The analysts' portfolio, up 17.5%, trailed the Wilshire and three of our other portfolios.

Company/business	Price recent	Price original*	Price % change	Latest 12 months EPS	Latest 12 months P/E	Yield	Book value	1985 EPS estimate current	1985 EPS estimate July '84
Alcan Aluminium Ltd/aluminum	30⅞	27½	12%	$2.21	14.0	3.9%	$28.88	$3.38	$6.44
Allen Group/auto parts	19¼	18	6	1.59	12.4	3.0	12.36	2.65	3.27
Aluminum Co of Am/aluminum	39⅛	32⅞	19	3.13	12.5	3.1	41.36	4.77	7.14
Arrow Electronics/electronics	16⅞	21⅝	–22	2.11	8.0	1.2	11.62	2.38	3.79
Black & Decker/tools	26¼	22⅜	17	1.96	13.4	2.4	11.76	2.36	2.75
Chesapeake/paper products	38⅛	32	21	3.35	11.5	3.2	29.59	3.93	4.81
Chrysler/auto	34⅛	25¼	35	7.31	4.7	2.9	14.31	12.08	11.03
Clark Equip/industrial equip	30⅞	28	10	1.73	17.8	3.6	32.49	2.89	4.79
Data General/computer equipment	56¾	48½	17	3.55	16.0	—	24.32	4.15	3.81
Esterline/precision inst	22¼	27⅛	–18	2.14	10.6	3.2	10.42	2.55	3.13
Federal Paper Board/paper products	22¼	18¼	25	2.93	7.8	3.1	14.41	3.55	3.41
Foxboro/electrical equip	28	29½	–5	0.49	57.1	3.7	23.65	2.10	3.34
Georgia-Pacific/paper, forest prods	27⅛	18⅝	46	2.24	12.1	2.9	19.48	3.04	3.53
BF Goodrich/tire and rubber	29⅞	28½	5	3.06	9.8	5.2	45.45	3.74	6.00
Joy Mfg/construct machinery	27	23¼	16	1.80	15.0	5.2	24.06	2.25	2.64
Koppers/diversified chemical	19¾	19⅜	2	1.28	15.4	4.1	19.39	2.18	2.86
Lotus Development/software	29¾	18¾	59	1.97	15.1	—	5.31	2.76	3.37
Marshall Inds/electronics	24	23¾	1	3.08	7.8	—	12.92	NA	3.58
Mead/paper & forest prods	39	31	26	4.17	9.4	3.1	31.06	5.46	5.59
Moore McCormack Res/cement	23⅞	21½	11	1.91	12.5	4.4	39.42	2.91	4.43
Paccar/trucks	50⅛	41¼	22	6.91	7.3	4.4	36.88	7.09	7.45
Signal Cos/industrial machinery	34	26⅝	28	2.39	14.2	2.9	23.00	3.19	3.45
Singer/precision inst	37⅜	28⅛	32	2.57	14.7	0.3	15.49	4.18	4.35
St Regis/paper & forest prods	55½†	37	50	NA	NA	—	NA	5.25	5.23
United Energy Res/natural gas	29¼	24	22	2.32	12.6	8.5	32.85	3.67	3.98

*As published in FORBES, July 30, 1984. †Acquired by Champion International. NA: Not available.

Sources: Wilshire Associates; Standard & Poor's Stockpak-II System; The Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan; Forbes

The low-P/E list is off to an early lead, with a gain of 27.2%, vs. 20.6% for the Wilshire index (both figures exclude dividends). It did well mostly because of the bank and utility stocks on it, groups that have recently recovered sharply from their depressed levels. The best stock on this list was Golden West Financial, up 123%.

In sharp contrast, the Pure Play Book Value Fund slipped 3.7% and recorded the worst performance during the initial stretch. This portfolio shows that book value is not the same as value. Look at Crompton Co. The books told only part of the story. Crompton, one of the oldest textile firms in the U.S., has seen its operating income decline over the past few years. Its bloated book value came from textile production machinery with limited resale value. Crompton filed for bankruptcy last October and is being liquidated.

During the same month, Transcontinental Energy also filed for bankruptcy under Chapter 11. Continental Illinois survived a painful restructuring. The future value of the bank is much in doubt, but some shareholders see another Chrysler and have bid the stock up.

Our 1967 dart board portfolio had

Last place: The Pure Play Book Value Fund

Now we know why Ben Graham said to look for more than just book value. This portfolio declined 3.7%

Company/business	Price recent	Price original*	% change	Latest 12 months EPS	Latest 12 months P/E	Yield	Book value	Estimated EPS 1985
Allied Supermarkets/supermarkets	2⅞	2⅝	10%	$ 0.00	NM	—	$7.23	$0.10
Barber-Greene/construct machinery	5	5	0	–11.14	NM	—	2.06	–3.05
Biotech Capital/venture capital	2⅝	2¼	17	NA	NA	—	3.68	NA
Charter Co/integrated oil	3⅜	2⅛	59	–39.88	NM	—	25.16	3.50
Consumers Power/electric utility	6¼	6⅛	2	1.66	3.8	—	25.92	1.46
Contl Illinois/bank holding	5½†	5⅝	–2	NA	NA	NA	NA	NA
Crocker National/bank holding	25½	16⅞	51	–15.93	NM	1.6%	52.80	2.48
Crompton/textiles	4½‡	9⅛	–51	NA	NA	—	NM	NA
Digicon/oilfield svcs	2⅝	4¾	–45	–12.32	NM	—	11.17	–2.42
Evans Products/building materials	4½	5⅜	–16	–6.96	NM	—	9.63	–1.50
General Pub Utils/electric utility	12¾	8½	50	1.53	8.3	—	24.23	1.97
Inspiration Res/metals and mining	5¼	8⅜	–37	–2.25	NM	—	15.59	0.45

A SMALL UNMANNED TROLLEY GOES INTO A DARK WAREHOUSE. IT UNLOADS AT ONE SHELF. IT THEN GETS AN ORDER TO PICK UP A BOX AT ANOTHER STATION. IT STOPS ON ITS WAY TO LET OTHER TROLLEYS PASS. IT FINDS THE STATION, PICKS UP THE BOX, TELLS THE COMPUTER TO REGISTER THE NEW STOCK SITUATION. IT GOES OUT INTO THE DAYLIGHT. IT DELIVERS THE BOX TO A TRUCK AT A LOADING BAY. WHEN IT PASSES THE DOORWAY IT CHARGES ITS ELECTRICAL BATTERIES THROUGH A CABLE.

AFTER THE JOB IS DONE, IT STOPS AND WAITS FOR A NEW ORDER. IT GOES 24 HOURS A DAY. IT NEVER FORGETS TO REGISTER WHAT IT IS DOING. IT IS A CARRIER FROM VOLVO AUTOMATED SYSTEMS, A COMPANY IN THE VOLVO GROUP.

VOLVO

Last place: The Pure Play Book Value Fund

Company/business	Price recent	Price original*	% change	Latest 12 months EPS	Latest 12 months P/E	Yield	Book value	Estimated EPS 1985
Keystone Consol Inds/steel	3	4¼	–29%	$–3.62	NM	—	$18.45	NA
Long Isl Lighting/electric utility	8¼	5⅜	53	3.01	2.7	—	19.28	$2.90
Manufacturers Hanover/bank holding	40¼	25⅜	59	7.12	5.7	8.0%	63.62	8.04
Manville/building materials	8½	8¼	3	1.47	5.8	—	34.62	1.13
Marine Midland Banks/bank holding	33⅜	20⅛	66	4.17	8.0	4.8	52.88	5.48
Offshore Logistics/oilfield svcs	2⅞	5¼	–45	–16.22	NM	—	7.99	–4.47
Peoples Restaurants/restaurants	⅜	1¼	–70	–3.59	NM	—	2.14	NA
Petro-Lewis/oil, gas explor, prod, dev	4	4¼	–6	–2.98	NM	—	4.61	–1.75
Public Svc Ind/electric utility	8⅛	8⅝	–6	2.07	3.9	12.3	27.24	1.11
Republic Steel/steel	22 **	22½	–2	NM	NM	NM	NM	NM
Transcontl Energy/oilfield svcs, energy	1/32†	¾	–89	NA	NA	—	NM	NA
Twin City Barge/maritime	1¼	1⅜	–29	–6.58	NM	—	0.50	–2.30
Wheeling-Pitt Steel/steel	14⅛	21⅝	–35	–4.62	NM	—	61.35	5.00

*As published in FORBES, July 30, 1984. †Recent value represents 1 share of Cont'l. Hldg. and 1 right to new Cont'l. Illinois. ‡Chapter 11 **Acquired by LTV. NA: Not available. NM: Not meaningful.

Sources: Wilshire Associates; Standard & Poor's Stockpak-II System; The Institutional Brokers Estimate System (IBES), a service of Lynch, Jones & Ryan; FORBES

one extremely lucky pick, Texas Oil & Gas, which jumped more than 7,000%. Lightning has yet to strike twice. But Iomega, on our random list of 1984, is up 129% in seven months. The random portfolio, with an 18.1% gain, seems to be mirroring the overall market. But give the computer credit for having picked two buyouts. American Sterilizer went private this February, a 38% gain on our imaginary investment. And K mart bought out Home Centers of America for $11 a share last September.

The Pure Play Analysts' Choice Fund, up 17.5%, performed slightly under the random group. The experts' predictions of handsome earnings gains, it seems, were already incorporated into most share prices. But the security analysts also hit on one acquisition, St. Regis, which was taken over by Champion International.

The Pure Play Growth Fund was the second-best group, with a 19.5% gain. The best issue: The Limited, up 96%. Dysan went from growth to deficits but still gained 44%, thanks to a pending merger with Xidex.

Stay tuned for further results. ■

VOLVO PENTA IS THE MOST 'INTERNATIONAL' OF ALL VOLVO COMPANIES, MARKETING MARINE AND INDUSTRIAL ENGINES AND PROVIDING AFTERSALES SUPPORT IN 130 MARKETS.

TWENTY-FIVE YEARS AGO VOLVO PENTA REVOLUTIONIZED THE MARINE POWER INDUSTRY WITH THE INTRODUCTION OF THE AQUAMATIC INBOARD/OUTBOARD DRIVE. THE AQUAMATIC DRIVE CAN NOW BE EQUIPPED WITH ANOTHER EXCITING INNOVATION, THE 'DUOPROP,' WHICH IMPROVES BOAT PERFORMANCE AND HANDLING, SAVES FUEL AND ENSURES THAT VOLVO PENTA WILL STAY COMPETITIVE IN THIS BUOYANT MARKET.

VOLVO

Bean traders can now choose one of two ways to take a market position. Either will let them indulge their taste for risk.

TAKE YOUR PICK

By Stanley W. Angrist

The U.S. Department of Agriculture published its final 1984-85 soybean crop report in late January, and it contained a little surprise for bean traders. However, the bullish report was diluted somewhat by the bearish corn report. Utilizing the USDA supply/demand estimates, it appears that the carryover will be only 174 million bushels, instead of the 270 million bushels envisioned by the trade.

These smaller numbers are causing more attention than usual to be devoted to the southern hemisphere crop. The leading Brazilian producing states have been dry and hot in recent weeks. Because weather shifts in the bean-producing states can occur rapidly, it is impossible at this writing to estimate the likelihood of weather damage.

The strong dollar is continuing to take its toll on exports, which are 23% below year-ago levels and 32% below the 1982-83 marketing-year sales. If the dryness persists in Brazil, an event that would cause the demand for U.S. beans to rise, our bean exports could exceed the currently estimated total of 720 million bushels. Last year exports were 740 million bushels.

There are three factors then that could cause a small rally in the bean market: 1) the reduced carryover stemming from the lower crop total for the year just ended; 2) the continuation of hot, dry weather in Brazil and; 3) a weakening in the U.S. dollar, which would make U.S. beans more attractive to overseas purchasers.

Given my bias toward the upside in this market, I will suggest two trading methods that might produce a profit. The first is an old crop/new crop bull futures spread. The second is a slightly bullish soybean option spread. The futures trade involves buying July, while selling the November contract. Try to do the spread with July at a premium of less than 4 cents to November. If the spread closed with July at more than an 8-cent discount to November, exit the position. (That level is the lowest the spread has reached this crop year.) I would look for a profit of 30 cents ($1,500 per spread) from my entry point. The table shows the results of this spread over the last 17 years. Margin on this spread is $250, with a round-turn commission of about $40 from a discount broker.

Since I last wrote about soybeans or its products, the Chicago Board of Trade has introduced options on soybean futures contracts. The strike prices are set at integral multiples of 25 cents per bushel, while the premiums and the strike prices are quoted in cents per bushel. Options provide another alternative for risk-takers in the bean market.

In this case, I believe that a bullish vertical call spread offers a reasonable profit opportunity with limited risk. I suggest buying the July 575 call and selling the July 650 call, with a net debit of no more than 30 cents. Such a trade would require a trader to put up the debit amount of 30 cents ($1,500). The maximum profit is the difference between the strike price of the option bought (575) and the option sold (650) less the debit amount (30 cents). Thus, in this case, the maximum profit is 45 cents, or $2,250 per spread. That means that the reward-to-risk ratio is 1.5. The break-even point for the spread is obtained by adding the debit amount to the strike price of the option purchased, giving a downside break-even of $6.05. That is, if July soybeans are at any price above $6.05 when the soybean options expire in mid-June, then the trade will show a profit.

The commission on this trade would be around $40 for both options on a round-turn basis from a discount broker. The advantage of the option trade over the futures trade is that the risk is limited absolutely to the debit amount. On the other hand, if the trade is held until the options expire and the price of beans is below $6.05, then all of the net debit premium ($1,500) will be lost. You pays your money and takes your choice. ■

Stanley W. Angrist is a commodity speculator, consultant and longtime observer of the commodity markets.

Bean time!

July beans have a pretty good track record for gaining on November beans from midwinter into spring. The median gain is about $750, the median loss about $425. The entry and exit positions are shown in cents per bushel for July beans minus November beans; the profit or loss in dollars per spread.

Year	Entry	Exit	Profit
1968	9.52¢	10.92¢	$ 70
1969	-25.57	33.52	397
1970	13.10	10.72	-119
1971	24.38	10.67	-685
1972	21.47	36.65	759
1973	67.63	351.80	14,208
1974	14.30	10.10	-210
1975	23.30	12.25	-552
1976	-13.80	-11.95	97
1977	33.20	227.70	8,725
1978	14.55	89.75	3,760
1979	43.15	15.05	-1,405
1980	-26.30	-29.55	-162
1981	-19.15	-25.40	-312
1982	-9.10	-7.15	97
1983	-7.85	-23.40	-777
1984	49.45	128.55	3,955